



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
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IN REPLY REFER TO

PSP 730.4A

November 8, 2004
04-PSP-062(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Discussion of Sarbanes-Oxley Act at Annual Audit Planning Meeting with Contractor

This memorandum reemphasizes existing guidance requiring auditors to discuss with the contractor, at the annual planning meeting, the audit work performed by the contractor to support its Sarbanes-Oxley Act requirements (CAM 4-202.1). We have enclosed a short PowerPoint presentation (Enclosure) to assist the FAO when conducting the briefing to facilitate identifying opportunities for relying on the contractor's efforts and coordinated audit planning.

Section 404 (Management Assessment of Internal Controls) of the Sarbanes-Oxley Act of 2002 requires SEC-registered companies to certify to the financial and other information contained in their quarterly and annual reports filed with the SEC. Companies are also to include, with their annual filing, a management report on the company's internal control over financial reporting. They are also required to include the independent auditor's attestation report on management's assessment of the company's internal control over financial reporting.


Public companies and their independent auditors may now perform additional audit effort to support the certification and reporting requirements under Section 404 of the Sarbanes-Oxley Act. Auditors should determine the potential for any increased opportunities for (1) relying on the work performed by the contractor and reducing our effort during our internal control audits, and (2) performing coordinated audits with the internal and external auditors to avoid duplication and reduce overall costs of audits to the company and the Government. CAM 4-1000 provides the audit guidance for relying on the work of others.

Field audit office personnel should direct questions regarding this memorandum to personnel in the regional office. If regional personnel are unable to answer or have questions of their own, they should contact Jeff Miller, Program Manager, Policy Special Projects Division, at (703) 767-3290 or email at DCAA-PSP@dcaa.mil.

/Signed/
Robert DiMucci
Assistant Director
Policy & Plans

Enclosure:
Sarbanes-Oxley Presentation


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**Sarbanes-Oxley Act - Section 404:
Annual Audit Planning Meeting**

FAO Manager
Branch Office

Month XX, 2004



Section 404: Management Assessment of Internal Controls
What Does It Require?

- Requires annual report to SEC contain an internal control report which must include:
 - ✓ Statement that management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting for the company
 - ✓ Management's assessment of the effectiveness of the internal control structure and procedures for financial reporting
 - ✓ Independent auditor's attestation on management's assessment

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Section 404: Management Assessment of Internal Controls

Requires annual report to SEC contain an internal control report which must include:

Statement that management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting

Management's assessment of the effectiveness of the internal control structure and procedures for financial reporting


Independent auditor's attestation on management's assessment.

On 2/26/2004 SEC extended the compliance dates:

Accelerated filers* - first fiscal year ending on or after November 15, 2004 (extended from June 15, 2004)

Others - first fiscal year ending on or after July 15, 2005 (extended from April 15, 2004)


Domestic Company with common equity public float \geq \$75 million that had been subject to Exchange Act reporting requirement for at least 12 months and that had previously filed at least an annual report.



Sarbanes-Oxley Act – Section 404 Management's Self Assessment

- When implementing Section 404, public companies and their independent auditors may perform additional audit and documentation effort to support the management's report on the company's internal control over financial reporting
- Company management may express increased interest in the FAO's audit plan, accomplished audit work related to internal controls, opportunities for coordinated audits, and in identifying and resolving significant internal control deficiencies cited during our previous audits


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Determine Potential for Relying on the Work of Others and Coordinated Audits

- DCAA & contractor assess the relevancy of the planned or performed audit work to support management's report on internal controls to the objectives of the DCAA internal control audits
- For example, DCAA & contractor review the following Sarbanes-Oxley internal control documentation for relevancy/impact on DCAA internal control audits:
 - ✓ System descriptions and internal control component documentation (CAM 5-102)
 - ✓ Control objectives and activities identified by each system
 - ✓ Key controls tested for each system

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Determine Potential for Relying on the Work of Others and Coordinated Audit Planning

- DCAA performs audits on the effectiveness of company internal controls over financial reporting, compliance, and operations related to 10 specific systems (Internal Control Audit Planning Summaries – ICAPS) that impact Government contracts on a cyclical basis, including:
 - ✓ Control Environment and Overall Accounting Controls
 - ✓ Information Technology System General Internal Controls
 - ✓ Budget and Planning System Internal Controls
 - ✓ Purchasing System Internal Controls
 - ✓ Material Management and Accounting System Internal Controls
 - ✓ Compensation System Reviews and Audit of Internal Controls
 - ✓ Labor System Internal Controls
 - ✓ Indirect and Other Direct Cost Internal Controls
 - ✓ Billing System Internal Controls
 - ✓ Estimating System Internal Controls

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Key Initial Step for Determining Potential for Relying on the Work of Others and Coordinated Audit Planning

- DCAA obtains a copy of the company system descriptions (narratives, flowcharts, etc.) of the relevant processes and sub-processes, including the control objectives and control activities, identified by the company during its Sarbanes-Oxley assessment at corporate and other Government business units


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Key Steps for Determining Potential for Relying on the Work of Others and Coordinated Audit Planning

- Based on understanding the company's systems of internal control:
 - ✓ Compare the company's process/systems descriptions with the accounting and management systems identified by DCAA and determine where any common control objectives exist (e.g., accounting system and controls)
 - ✓ Where common objectives exist, DCAA and the contractor jointly determine areas for potential reliance and coordinated audits
 - ✓ DCAA must follow Agency policy for relying on the work of others (CAM 4-1000)

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What are the Benefits?

- For the company:
 - ✓ Less time spent supporting DCAA audits of internal control systems
 - ✓ Provides the company a vehicle to demonstrate the effectiveness of its internal controls and highlight controls or compensating controls
- For the Government:
 - ✓ Reduced audit effort
 - ✓ Provides a comprehensive picture and understanding of the company's complex system of internal control facilitating a more efficient and effective audit

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